No. 87-2026

In the Supreme Court
of the United States

OCTOBER TERM, 1987

JAMES E. SOCHIN, *Petitioner*,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH JUDICIAL CIRCUIT

PETITIONER'S MEMORANDUM IN REPLY TO RESPONDENT'S OPPOSITION

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TABLE OF AUTHORITIES

PETITIONER'S MEMORANDUM IN REPLY

1) This petition was filed because more and more frequently, as happened in this case, the Commissioner of Internal Revenue has been able to prevail upon some of the lower federal courts to avoid the application of hard statutory requirements by declaring, *ad hoc*, that a transaction was a "sham" and, thus, not entitled to further consideration under the nation's tax laws. The tax court and the court of appeals took that approach in this case, but, in similar situations the courts of appeals for both the second and fourth circuits have required a more discerning, and more objective, approach. *Compare* this case, *Sochin v. Commissioner*, 843 F.2d 351, 61 AFTR2d 926 (9th Cir. 1988), *with United States v. Philatelic Leasing, Ltd.*, 794 F.2d 781, 58 AFTR2d 5285 (2nd Cir. 1986), and *Rice's Toyota World, Inc. v. Commissioner*, 752 F.2d 89, 55 AFTR2d 580 (4th Cir. 1985).

In this court's *constitutional* jurisprudence, flexible balancing tests are often found to be appropriate in weighing or measuring evidence submitted at trial because of the inherently broad reach of constitutional provisions. Cases involving the Fifth Amendment and Fourteenth Amendment usually apply this method of adjudication. See, for example, *Tulsa Collection Services v. Pope*, 99 L.Ed2d 565, at 574-575 (1988).

By contrast, however, in matters of *statutory* interpretation, this court more frequently gives clear guidance to the lower courts by requiring the lower courts to measure trial evidence according to more precise and exacting standards. For example, in *Patrick v. Burget*, 100 L.Ed2d 83, 91-92 (1988) this court mandated a "rigorous two-part test" to measure evidence under a section of the federal anti-trust laws. That is the kind of rule petitioner is contending for here in this federal tax case.

The imposition of these tests is not mere semantics, as respondent suggests at page 6 of his memorandum, but is a reflection of this court's general requirement that litigants be treated fairly and that each litigant be given a chance to present evidence that will be measured according to a clearly stated standard, thus providing some assurance that similarly situated litigants, whether a citizen or a governmental entity, will be treated similarly. Recently this court reemphasized its "abiding rule that it treat all litigants equally: that is, that the claim of any litigant for the application of a rule to its case should not be influenced by the Court's view of the worthiness of the litigant in terms of extralegal criteria." *Patterson v. McLean Credit Union*, 99 L.Ed2d 879, 881 (1988).

Therefore, the approach of the Commissioner of Internal Revenue in this case and of the two courts below, as repeated in the respondent's memorandum, that the taxpayer, Mr. Sochin, tried to save a lot of tax and, therefore, should not have the benefit of an objective standard and of the rules enacted by Congress and the President, should be rejected.

2) Respondent also argues (memorandum pp. 6-7) that the result in this case will be no different even if the two-part test of *Rice's Toyota* were to be applied to the evidence of record. That is not true. The courts below found that, looking at the evidence as a whole, and not being required by any precise standard to examine *the taxpayer's* motives and the specific transactions *he* used, the whole program was a "sham." But that is the very point. The two-part test requested here by petitioner would require the courts below to change their focus on remand and to examine the taxpayer's *own* motives and purposes and the specifics of *his* trades. This would prohibit the lower courts on remand from doing what they did at first, brand Mr. Sochin as illegitimate and unworthy merely because *other* taxpayers may have treated the investment program as a sham.

3) Finally, the respondent argues at pages 6-7 (note 4) of his memorandum that the petition should be denied because the tax court has interpreted the underlying tax statute in this case (section 108 of Pub. L. 98-369, as amended) as requiring a primary profit motive. It is not clear just why the petition should be denied on that ground. In any event, the respondent failed to mention that the rule in the ninth circuit (which controls this case) is different: under section 108 the investment must have a reasonable prospect of profit, not necessarily a primary profit motive, in order to permit deduction of transaction losses. See *Wehrly v. United States*, 808 F.2d 1311, 58 AFTR2d 5260 (9th Cir. 1986).

4) In conclusion, the lower federal courts, including the tax court, are in disarray as to what standard to apply to the trial evidence to determine whether statutory rules can be avoided when the Commissioner of Internal Revenue comes into court contending that a transaction is a "sham." As detailed in our petition, this case presents an ideal vehicle for this court to provide direction on that point by extending its holdings in *Frank Lyon and Company v. United States*, 435 U.S. 561, 55 L.Ed2d 550, 98 S. Ct. 1291, 41 AFTR2d 1142 (1978) and *Commissioner v. Bollinger*, 485 U.S. ___, 99 L.Ed2d 357, 108 S. Ct. 1173, 61 AFTR2d 793 (1988), to the class of case (speculative investment) presented by this record.

We therefore respectfully request that the petition be granted.

AUG 22 1988

Date

/S/ JOSEPH WETZEL

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CERTIFICATE OF SERVICE

Pursuant to Rules 28.3 and 28.4 of the Rules of the Supreme Court of the United States, this certifies that three copies of the foregoing petitioner's memorandum in reply to respondent's opposition were served on:

Mr. Charles Fried
United States Solicitor General
Department of Justice
Washington, D.C. 20530

All parties required to be served have been served. All service was done by mail with postage prepaid on August 22, 1988.

AUG 22 1988 /S/ JOSEPH WETZEL

Date

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